

Why Economic Growth Trends Differ So Much across Developing Countries in the Era of Globalisation

PETER NUNNENKAMP

The claim of globalisation critics that the income gap with industrial countries is bound to widen for essentially all developing countries as a consequence of economic globalisation is in conflict with empirical evidence. Economic performance differs tremendously across developing countries. We discuss several factors such as capital accumulation, openness to trade, and foreign indebtedness which may explain the varying experience with globalisation in regard to per capita income growth and income distribution. Economic restructuring is shown to represent an important—though frequently neglected—link between globalisation and country-specific performance. We conclude that national policy-makers continue to have effective leverage to promote economic catching-up and poverty alleviation in the countries they govern.

I. INTRODUCTION

Listening to globalisation critics, it appears that essentially all countries are fighting a losing battle in dealing with economic globalisation. Globalisation is blamed for having caused unemployment, wage pressure and social erosion in industrial countries. More specifically, the integration of developing and newly industrialising countries into the global division of labour is said to result in significant labour market pressure in industrial countries. At the same time, many developing countries are supposed to be left on the sidelines when it comes to participating in globalisation. The few winners of globalisation seem to have gone after various emerging markets were hit by severe financial crises since the mid-1990s.

Obviously, globalisation critics do not care much about consistency in their reasoning. How to attribute labour market problems in industrial countries to the emergence of new competitors with lower per-capita income, if most developing countries remained outsiders and if international income diversity widened across the board? The solution to this “puzzle”, suggested in this paper, is that easy generalisations are inappropriate for assessing the consequences of globalisation. Economic performance differs tremendously, both within the group of industrial countries and within the group of developing and emerging economies, even though the globalising environment was very much the same for all countries.

Peter Nunnenkamp is Research Division Head at Kiel Institute for World Economics, Germany.

The relevant question therefore is to identify the factors behind the varying experience with globalisation.¹ According to our basic proposition, economic restructuring represents the crucial—and often neglected—link between globalisation and country-specific performance. As a corollary of this proposition, we reject the widely held belief that globalisation renders national policy-makers powerless. National policy-makers continue to have effective leverage to promote a process of economic catching up and poverty alleviation in the countries they govern.

II. INTEGRATION OF DEVELOPING COUNTRIES IN THE GLOBAL DIVISION OF LABOUR: SOME STYLISTED FACTS

The generalised claim of globalisation critics that developing countries are left on the sidelines is in serious conflict with patterns of international trade and foreign direct investment (FDI), which represent the two major driving forces of globalisation. It is true, however, that various groups of developing countries participated in globalisation to a strikingly different degree.

All non-OECD countries taken together succeeded in increasingly penetrating the markets for manufactured goods in industrial countries. During the 1990s, developing countries increased their market share in OECD countries from 18 percent to 26 percent [OECD (2001)]. Asian developing countries further strengthened their market position, and supplied about two thirds of OECD imports of manufactured goods from all developing countries in 1999.² This development is particularly striking, as various protectionist measures (notably non-tariff measures) of industrial countries targeted Asian competitors in the first place.

By contrast, suppliers from Africa were granted trade preferences, e.g. in the context of the EU's agreement with ACP countries. Nonetheless, Africa suffered persistent marginalisation in OECD markets for manufactured goods. This contrast suggests that local supply conditions were more important than discriminatory trade policies of OECD countries for shaping the developing countries' participation in world trade.

The picture is similar with regard to FDI. All developing countries hosted one third of worldwide FDI stocks in 2000, a rise of more than seven percentage points within a decade [UNCTAD (2001)]. However, booming FDI did not benefit all developing countries alike:³

- The recent financial crisis notwithstanding, Asia remained the most attractive host region for foreign direct investors.
- The rising share of Central and Eastern Europe in worldwide FDI flows is obviously related to the demise of socialist regimes in this region, the opening

¹ The performance of industrial countries in the era of globalisation is not discussed in this paper; see Gundlach and Nunnenkamp (1997) on this issue.

² For a detailed statistical presentation, see Nunnenkamp (2002).

³ For a more detailed evaluation, see Nunnenkamp (2001).

up towards world markets and the prospect of accession to the EU.

- Latin American countries were concerned that the emergence of Central and Eastern Europe as a new competitor for FDI would result in FDI diversion at their expense. The evidence suggests otherwise. The observation that Latin America regained attractiveness to FDI in the course of the 1990s supports the view that new investment opportunities give rise to *additional* FDI, rather than resulting in FDI diversion.
- As in trade, Africa's share in global FDI continued to decline, even though average annual FDI flows to Africa almost doubled when comparing 1989–94 and 1995–2000.

A widely perceived problem with FDI in developing countries concerns its high concentration in a few large and fairly advanced developing economies [e.g. UNCTAD (1995); Collins (1998)]. This notion seems to imply that most developing countries do not have reasonable chances to attract FDI. However, this concern is largely unjustified as it is based on the distribution of FDI in absolute terms.

The upper panel of Figure 1 lists the 20 top performers among developing countries, measured by inward FDI stocks in 1998.⁴ This rather small group indeed accounted for more than 80 percent of inward FDI stocks in all developing countries. It is also true that the group of top performers in absolute terms mainly consists of either large countries such as China, Brazil, Indonesia, Mexico and Argentina, or economies with fairly high per-capita income such as Hong Kong and Singapore. This ranking provides a distorted picture on developing countries' attractiveness to FDI.

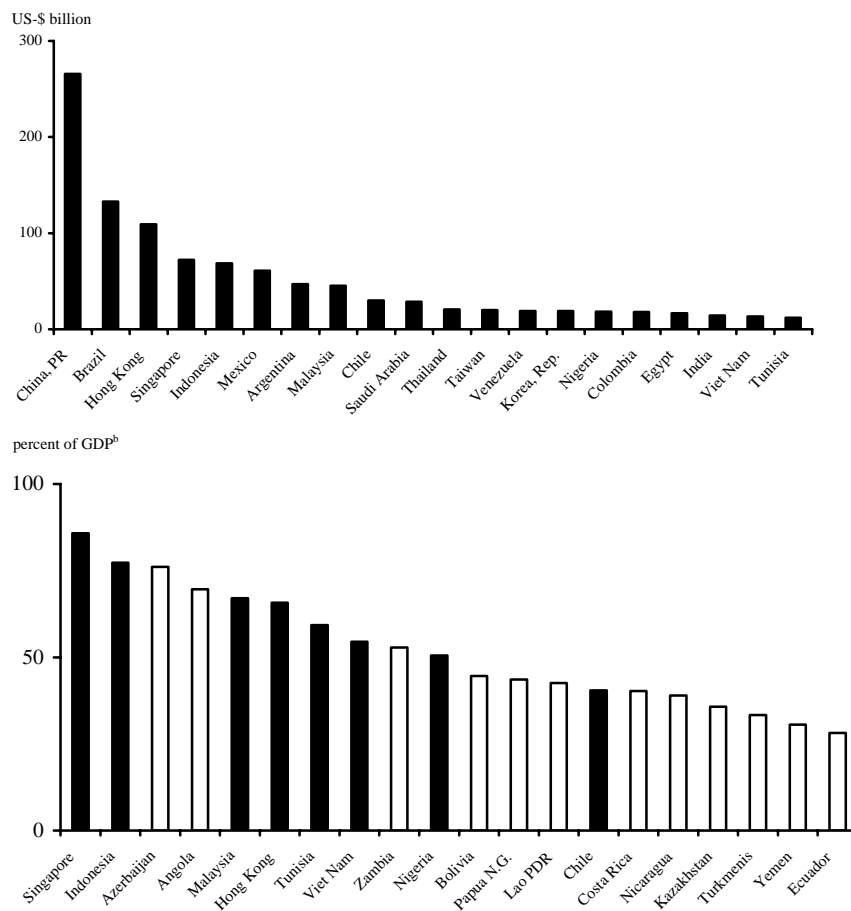
Inward FDI stocks have to be considered in relative terms, in order to avoid a large-country bias and assess locational attractiveness appropriately.

The lower panel of Figure 1 relates inward FDI stocks to the host countries' GDP.⁵ Caribbean tax havens and developing countries with a population of less than three million are excluded from this ranking; both groups include economies with extremely high FDI/GDP ratios, which may be due to a few FDI projects in the case of very small countries. Even though the sample is reduced in this way, the ranking changes significantly when inward FDI stocks are considered in relative terms.⁶ Just eight of the 20 top performers in absolute terms are also among the 20 top performers in relative terms (see the shaded bars in Figure 1). Moreover, the distribution of inward FDI in relative terms is considerably less uneven than the distribution of absolute stocks. In conclusion, there is little justification for the pessimistic view, according to which just a few developing countries can draw on FDI.

⁴ In 1998, Pakistan hosted US\$ 9.2 billion of FDI stocks and ranked 22nd.

⁵ By this measure, Pakistan (14.4 percent) was significantly less attractive than Yemen and Ecuador (28–30 percent), which represented the tail of the top 20.

⁶ FDI is largely resource-based in several smaller and less advanced countries with high FDI/GDP ratios (e.g., in Azerbaijan, Angola and Zambia). Nevertheless, a fairly heterogeneous set of smaller and less advanced countries proved attractive to FDI in relative terms; for details, see Nunnenkamp (2001: 6 ff.) and the literature given there.



Source: UNCTAD (2000).

^aExcluding Caribbean financial centres. ^bExcluding developing countries with a population of 3 million and less. Countries with shaded bars belong to the top performers in absolute terms.

Fig. 1. Inward FDI Stocks: Top 20 Developing Countries^a, 1998 US-\$ Billion.

III. CATCHING UP AND FALLING BACK

Penetrating OECD markets and attracting FDI are not ends in themselves. Rather, the integration of developing countries into global trade and investment patterns should be considered a means to spur economic growth. Exports generate revenues which may be used to finance urgently needed imports of capital goods. These, in turn, tend to increase labour productivity and offer income gains. FDI inflows do not only allow for higher investment, but may also provide access to internationally available technologies and management know-how.

It is here that globalisation critics seem to have an important point. They are right in stressing that developing countries which suffered a widening income gap to industrial countries outnumber developing countries which narrowed the income gap. Nunnenkamp (2002) considers the change in per-capita income (purchasing power parity) of developing countries in 1980–2000, relative to the per-capita income of the United States, to indicate longer-term processes of catching up and falling back. By this measure, the balance of catching up versus falling back is most heavily tilted to the latter in Africa, where just two out of 31 countries narrowed the income gap to the United States.⁷ By contrast, almost all sample countries in Asia have caught up economically. While relative income gains remained small in South Asian economies, including Pakistan, some East and Southeast Asian economies reported substantial gains in relative income.

The claim of globalisation critics that increasing world-market integration went along with widening income disparities between countries is countered by the World Bank (2002: 1 f.): “Between countries, globalisation is now mostly reducing inequality”. This conclusion holds once the number of people living in weak and strong growth performers among developing countries is taken into account.⁸ Furthermore, globalisation critics tend to ignore that it is one thing to list the large number of countries falling back, and a completely different thing to argue that these countries were bound to fall back because of globalisation.

In an earlier paper, we ran some simple correlations in order to get a clue of factors that may explain the vastly different growth performance across developing countries.⁹ Table 1 summarises relevant findings:

- First, economic growth was correlated with restructuring of employment and production. For example, higher growth was achieved where the employment share of agriculture declined more significantly.¹⁰ The correlation becomes even stronger when the change in the employment share of agriculture in 1980–1990 is correlated with the change in per-capita income since 1987 (instead of 1980). This suggests that restructuring employment was a cause, rather than a consequence of higher income growth.

⁷Likewise, most Latin American countries experienced lower income growth in 1980–2000 than the benchmark of industrial countries represented by the United States. In contrast to Africa, however, much depends on the period of observation in the case of Latin America. One in two Latin American countries outperformed the United States in terms of per-capita income growth in 1987–1995, when economic policy reforms gathered momentum in this region [Nunnenkamp (1998)].

⁸According to World Bank (2002), about 3 billion people live in “new globalising” developing countries, reporting a considerably higher per-capita income growth than industrial countries in the 1990s. On the other hand, developing countries with about 2 billion people have been left out of the process of globalisation.

⁹For data sources and a detailed discussion of results, see Nunnenkamp (1998a).

¹⁰Note that this correlation turned out to be significant despite growth-reducing effects resulting from distortionary government policies. In various developing countries, scarce resources were misallocated by (implicit) taxation of agriculture and the corresponding subsidisation of industry [World Bank (1986), Chapter 4].

Table 1

*Income Developments, Economic Restructuring, and Economic Policy:
Cross-country Correlations^a*

Correlation with	Change in Per Capita Income, Relative to the US, 1980–1995
Change in employment share of agriculture, 1980–1990	–0.52* (74)
Change in the share of manufactured exports in total exports, 1980–1995	0.35* (35)
Index of export concentration, 1980	–0.33* (70)
Average share of investment in GDP, 1980–1995	0.55* (57)
Average years of schooling, 1990	0.43* (62)
Change in the share of imports in GDP, 1993–1995 <i>vis-à-vis</i> 1980–1982	0.32* (65)
Growth of imports of capital goods, 1980–1994	0.74* (38)
Growth of stocks of foreign direct investment, 1985–1990	0.50* (68)

Source: Nunnenkamp (1998a).

^aNumber of observations in brackets. * Significant at 5 percent level.

- Second, an increasing share of manufactured exports in total exports and a more diversified export structure went along with higher income growth. Additional calculations (in which the income variable was lagged) revealed that the restructuring of exports preceded, rather than followed catching up.
- Third, growth trends are significantly correlated with factor accumulation, i.e. variables which national policy-makers can influence in order to promote economic restructuring and productivity gains. The more resources were devoted to investment, the higher was per-capita income growth. This applied not only to fixed capital formation but also to human capital formation, proxied by average years of schooling in Table 1. The latter result is in line with findings of Barro (1991) and Mankiw, *et al.* (1992), according to which differences in human capital formation explain a significant part of cross-country differences in per-capita income.
- Finally, the correlations support the view that catching up is easier when countries open up towards the world economy [Sachs and Warner (1995)]. All three indicators of openness considered in Table 1 are correlated positively with income growth.¹¹ In particular, the calculations underline the relevance of

¹¹One must obviously be careful about drawing conclusions on causality. However, as Peter Lindert and Jeffrey Williamson note with reference to the trade-growth link, “the doubts that one can retain about each individual study threaten to block our view of the overall forest of evidence. Even though no one study can establish that openness to trade has unambiguously helped the representative Third World economy, the preponderance of evidence supports this conclusion”. [quoted as in World Bank (2002: 5)].

capital goods imports and FDI for achieving income gains by drawing on internationally available technologies.

In summary, the correlations support our basic proposition that economic restructuring as well as policies encouraging factor accumulation help developing countries narrow the income gap to industrial countries. It also turns out that globalisation critics are wrong to conclude from the large number of developing countries having fallen back that openness to trade and FDI utterly failed to deliver income gains.

IV. ECONOMIC GROWTH, FACTOR ACCUMULATION, AND OPENNESS: HOW PAKISTAN COMPARES WITH OTHER EMERGING MARKETS

In this section, we reconsider the empirical nexus between factor accumulation, openness and economic growth for a sample of 18 emerging economies in Asia, Latin America and Central Europe; the period of observation for changes in per-capita income, relative to the United States, is 1985–2000. The reason is that various emerging economies have been hit by financial crises since the 1990s. These countries are frequently labelled the latest victims of globalisation, a conclusion which is shown to be mistaken. Pakistan is included in our sample, whenever comparable data are available, in order to provide a clue of some policy challenges facing this country. Even though Pakistan was not seriously affected by the East Asian crisis, it had to reschedule its foreign debt owed to the Paris Club and private bondholders in 1999.

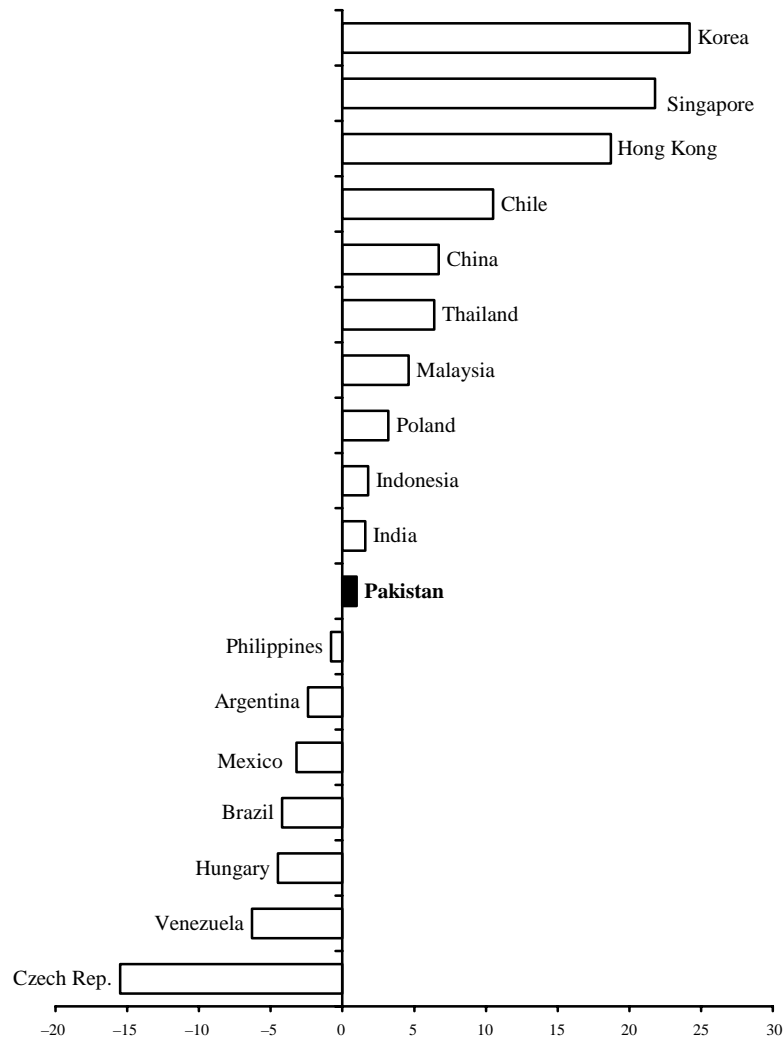
Growth trends differed tremendously across emerging markets (Figure 2). While per-capita incomes in some Latin American and Central European countries¹² declined considerably relative to per-capita income in the United States, some Asian economies narrowed the income gap by about 20 percentage points. Catching up was less impressive in Thailand, Malaysia and Indonesia than in Korea. Yet the ranking in Figure 2 is clearly at odds with the claim that financial crises in these four Asian economies have nullified previous gains from globalisation.

As mentioned before, Pakistan's growth performance was rather poor, particularly by Asian standards. The subsequent evidence does not provide a comprehensive explanation; yet it indicates major challenges facing Pakistan:

- In the 1990s, Pakistan reported the lowest investment ratio among the 18 sample countries [Nunnenkamp (2002), Figure 10]. This is most likely to have hindered catching up. Plotting annual average investment ratios against

¹²The extremely poor performance of The Czech Republic, especially compared to Poland, is due to two factors. According to World Bank data on per-capita GNP (in purchasing power parity), the former Czechoslovakia suffered a much more serious transition crisis than Poland in the early 1990s. Furthermore, per-capita GNP declined in the Czech Republic in the late 1990s.

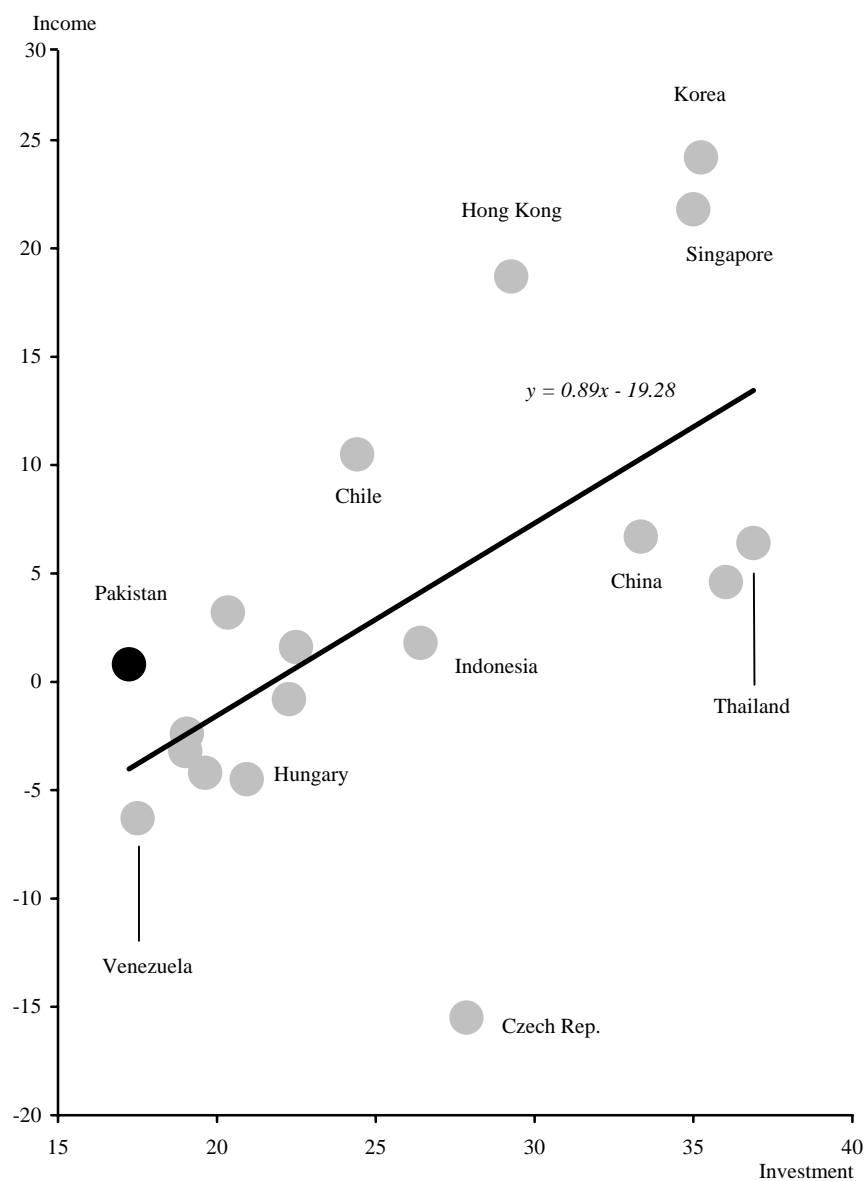
the change in per-capita income of our sample countries, Figure 3 reveals a clearly positive correlation. The coefficient of the investment variable is significant at the 1 percent level.



Source: World Bank (a).

^aChange in per capita income (PPP), relative to the United States, in 1985–2000 (percentage points).

Fig. 2. Emerging Markets: Catching Up and Falling Back^a, 1985–2000.



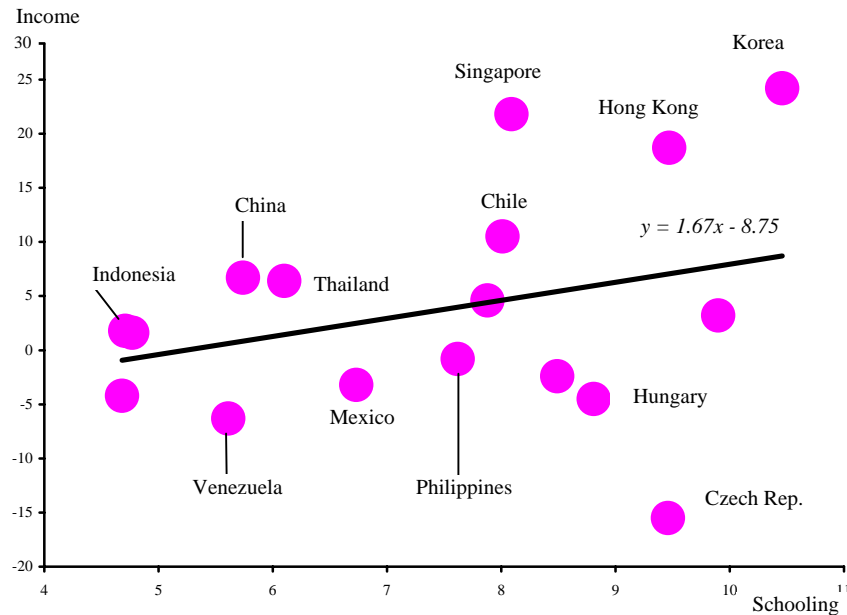
Source: World Bank (a).

^aChange in per capita income (PPP), relative to the United States, in 1985–2000 (percentage points).

^bAverage share of gross domestic fixed capital formation in GDP, 1990–1999.

Fig. 3. Per Capita Income Growth^a and Investment.^b

- Some proxies of human capital formation indicate that Pakistan was far down the list in this regard, too.¹³ Taking the correlation results of Figure 4 on average years of schooling (for which strictly comparable data were not available in the case of Pakistan) and income growth as a yardstick,¹⁴ insufficient human capital formation represented a second bottleneck to catching up more quickly.



Source: World Bank (a); World Economic Forum (2000).

^aChange in per capita income (PPP), relative to the United States, in 1985–2000 (percentage points).

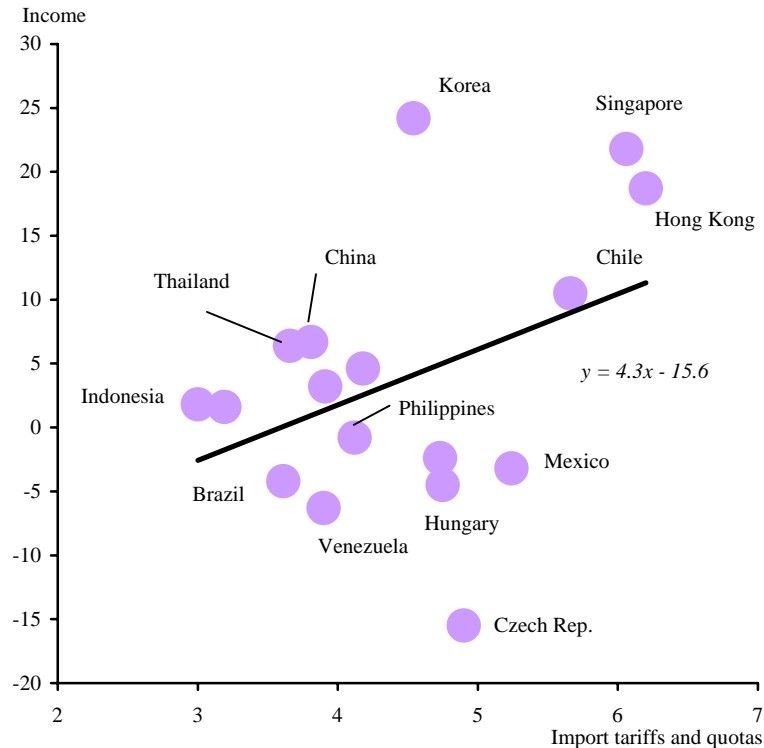
^bRefers to population age 25 and up; Pakistan not included as strictly comparable data on schooling were not available.

Fig. 4. Per Capita Income Growth^a and Average Years of Schooling.^b

¹³ For example, public spending on education amounted to 2.8 percent of GNP in Pakistan in 1995. Among the 18 countries under consideration, only Indonesia and China reported a lower share (1.4 and 2.3 percent, respectively); the sample average was 3.7 percent. Moreover, Pakistan ranked at the bottom by a wide margin with regard to secondary school enrollment (23 percent in 1990, compared to a sample average of 60 percent). All data are from World Bank (a).

¹⁴ Similar results were achieved when taking 1990-data on secondary school enrollment (in percent of the population of the relevant age group) as the independent variable. The rather poor statistical fit of the equation given in Figure 4 (adjusted R²: 0.03) improves considerably when the Czech Republic and Hungary are excluded from the regression (adjusted R²: 0.31; coefficient of the schooling variable significant at the 2 percent level). Both countries rank fairly high in terms of schooling, while their poor growth performance in the period under consideration was largely due to the transition crisis following the (political and economic) regime change.

- A third factor impeding a more favourable growth performance of Pakistan seems to be related to openness to trade. According to Figure 5, emerging economies with relatively low import barriers tend to grow faster than more closed economies.¹⁵ Again, Pakistan had to be excluded from this correlation exercise, as comparable data were lacking. Yet Pakistan can be classified a relatively closed economy according to World Bank data on the significance of import duties. In percent of imports, duties were higher only in India (22 percent) than in Pakistan (19 percent).¹⁶



Source: World Bank (a); World Economic Forum (1999).

^aChange in per-capita income (PPP), relative to the United States, in 1985–2000 (percentage points).

^bImport tariffs and quotas; score ranging from 1 (=highest import barriers) to 7 (=lowest import barriers); Pakistan not available.

Fig. 5. Per Capita Income Growth^a and Openness to Trade.^b

¹⁵ The level of significance of the openness variable improves from 12 percent to 4 percent, if the Czech Republic is excluded from the regression given in Figure 5.

¹⁶ Import duties averaged 7 percent of imports in 15 sample countries (comparable data were not available from World Bank (a) for Brazil, Chile and Hong Kong); all figures on import duties refer to 1997.

All in all, the evidence leads to three conclusions. First, income gains achieved by some emerging economies in the process of globalisation have not been erased by recent financial crises. Second, the statistical relations between income growth and some of its driving forces, identified in previous research for a larger group of developing countries, appear to be validated for emerging economies even in times of financial market volatility. Third, Pakistan fits into the general picture, as its poor record on factor accumulation and openness went along with a persistently large income gap with industrial countries.

V. SOME UNJUSTIFIED CONCERNS

Several objections may be raised against the reasoning in the previous sections. Two major concerns of globalisation sceptics are discussed in the following, namely that foreign indebtedness hinders economic catching up, however favourable other growth determinants might be, and that world market integration results in greater income inequality within emerging economies. Both concerns are of relevance to Pakistan, a low-income country with a high incidence of absolute poverty¹⁷ and a significant foreign debt.¹⁸

Excessive foreign debt may hinder economic growth by providing a disincentive to investment.¹⁹ In case of a debt overhang, the present value of expected debt-service payments falls short of outstanding foreign debt. The debtor country may service its debt fully by increasing investment, but has little incentive to do so as the returns to investment will accrue to foreign creditors exclusively. This reasoning is underlying the argument that debt relief may benefit not only debtors (by adding to their disposable income) but also foreign creditors (by expanding overall income to be shared by debtors and creditors).

The empirical relevance of this reasoning to our sample of emerging economies can be assessed by correlating their foreign debt burden with investment and income growth. The correlation should be negative, if high foreign debt discouraged investment and growth. The foreign debt burden is measured by total external debt outstanding in 1990, in percent of the debtor countries' GNP [World Bank (2000)].²⁰

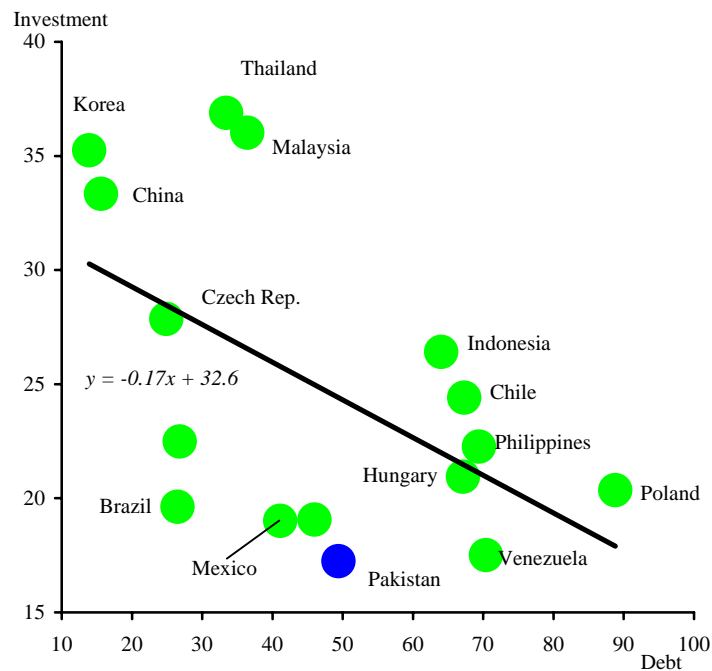
¹⁷According to World Bank (2001: Annex Table 2), almost 85 percent of the population lived on less than US\$ 2 per day.

¹⁸In World Bank (2000), Pakistan was classified as moderately indebted, which means that the present value of debt service exceeded 132 percent of exports or 48 percent of GNP.

¹⁹For a more rigorous analysis, see Corden (1988) as well as Sachs and Huizinga (1987).

²⁰From this source, data on the *present value* of external debt is available only since the late 1990s. Taking 1999-data on this variable results in completely insignificant correlations with both the investment ratio and per-capita income growth. However, this procedure does not capture possible effects of debt on *subsequent* investment and growth.

Disincentive effects of foreign debt appear to be relevant with regard to the investment ratio in the 1990s. The adjusted R^2 of the equation given in Figure 6 is 0.24, and the coefficient of the debt variable is significant (at 3 percent).²¹ Yet, per-capita income growth was not affected by a higher foreign debt burden; the coefficient of the debt variable in Figure 7 is insignificant and the adjusted R^2 of the equation is even negative. Taken together, these results are in some conflict with the proposition of a debt overhang in highly indebted emerging economies within our sample. It rather seems that productivity increases in countries with a higher debt burden and a lower investment ratio were roughly comparable to productivity increases in less indebted countries. A possible explanation is that financing constraints resulting from a high debt burden have led debtors to cut less productive investment in the first place, whereas the debt-overhang proposition would suggest otherwise.



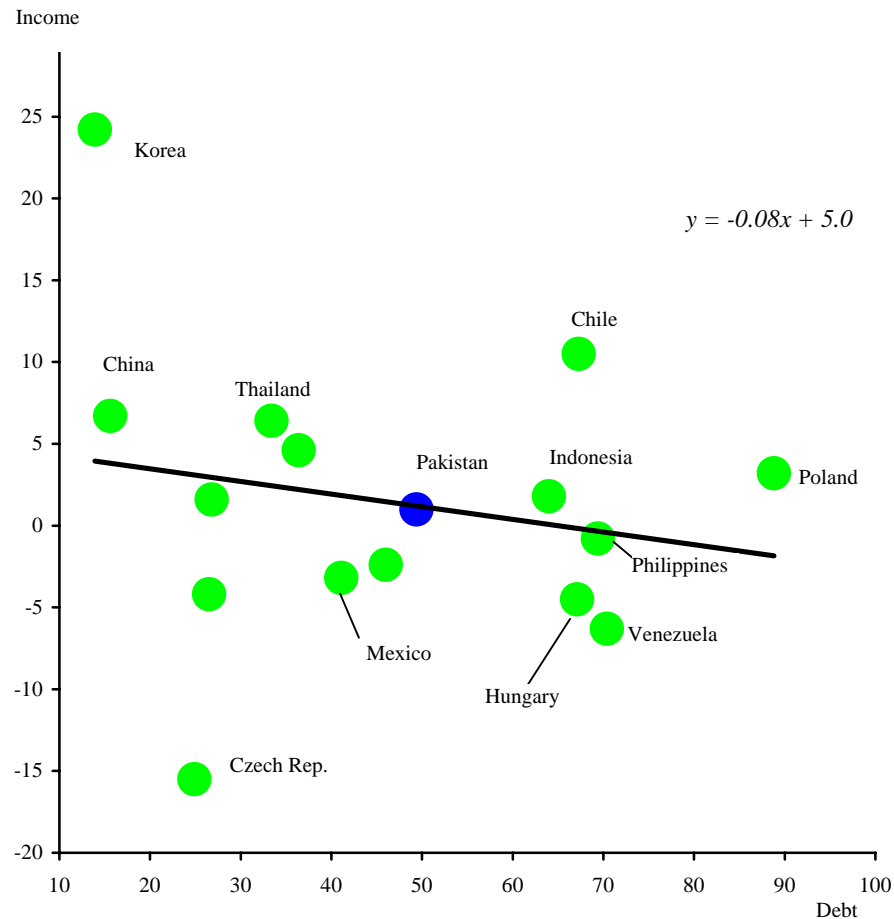
Source: World Bank (a); World Bank (2000).

^aPercent of GDP; period average for 1990–1999 (Pakistan: 1990–1998).

^bTotal external debt outstanding in 1990 (the Czech Republic: 1992) in percent of gross national product; not available for Hong Kong and Singapore.

Fig. 6. Gross Fixed Investment^a and Foreign Indebtedness.^b

²¹The correlation turned out to be somewhat weaker when the debt variable was defined as total debt-service payments in 1990, in percent of exports of goods and services.



Source: World Bank (a); World Bank (2000).

^aChange in per capita income (PPP), relative to the United States, in 1985–2000 (percentage points).

^bTotal external debt outstanding in 1990 (The Czech Republic:1992) in percent of gross national product; not available for Hong Kong and Singapore.

Fig. 7. Per Capita Income Growth^a and Foreign Indebtedness.^b

There is no convincing evidence either justifying the concern that world-market integration and the ensuing overall income gains come at the cost of increasing income inequality within emerging economies. A substantial body of research rather suggests that economic growth and poverty alleviation go hand in hand.²²

²²For a recent overview, see World Bank (2002).

- Moser and Ichida (2001) focus on three non-income measures of poverty in Sub-Saharan Africa. They find that economic growth was an important factor leading to higher life expectancy, declining infant mortality and increasing rates of primary school enrollment in 1972–1997. Furthermore, they find no evidence that the adoption of structural adjustment programmes has increased poverty in this region.
- Dollar and Kraay (2000, 2001) analyse the relationships between trade, economic growth, poverty and income inequality. According to their findings, income of the poor rose one-for-one with overall growth and did not fall more than proportionately during economic crises. The authors show that a group of “post-1980 globalisers” among developing countries outperformed the rich industrial countries in terms of economic growth in the 1990s, which was in sharp contrast to the rest of the developing world.²³ The analysis reveals a strongly positive effect of trade on growth, whereas there is little systematic evidence of a relationship between changes in trade volumes (or other globalisation measures) and changes in the income share of poor segments of the population. The authors conclude that openness to foreign trade benefits the poor to the same extent that it benefits the whole economy.
- The message that trade liberalisation has a positive effect on employment and income of the poor is echoed by Bannister and Thugge (2001). It is stressed, however, that the links between trade reform and poverty are diverse and complex, and that the transitional costs of trade reform may fall disproportionately on the poor. Therefore, the authors suggest to mitigate transitional costs by carefully designing trade reform, and to implement complementary reforms that facilitate the participation of the poor in formal markets (e.g. provision of infrastructure, technical assistance, credit and training).

Rather than delving deeper into the analytical links between trade reform, economic growth and poverty alleviation, or trying to explain diverse episodes in specific countries, we stick to our simple correlation approach to check whether the experience across our sample of 18 emerging economies is more in line with the research just summarised or with the claims of globalisation critics. We consider the Gini index and, where possible, its change over time as a measure of income inequality.

The focus on relative poverty means that absolute poverty may well have declined even if openness to trade and economic catching up were associated with

²³At the same time, the number of poor people “is falling rapidly in the new globalisers and rising in the rest of the developing world” [World Bank (2002: 7)].

higher income inequality. However, the correlations suggest that relative poverty was not significantly affected by more liberal trade policies and higher overall income growth in our sample. The adjusted R^2 s of all correlations [reported in more detail in Nunnenkamp (2002)] are extremely low (mostly even negative), and the coefficients of the trade and growth variables do not meet most generous requirements in terms of significance.

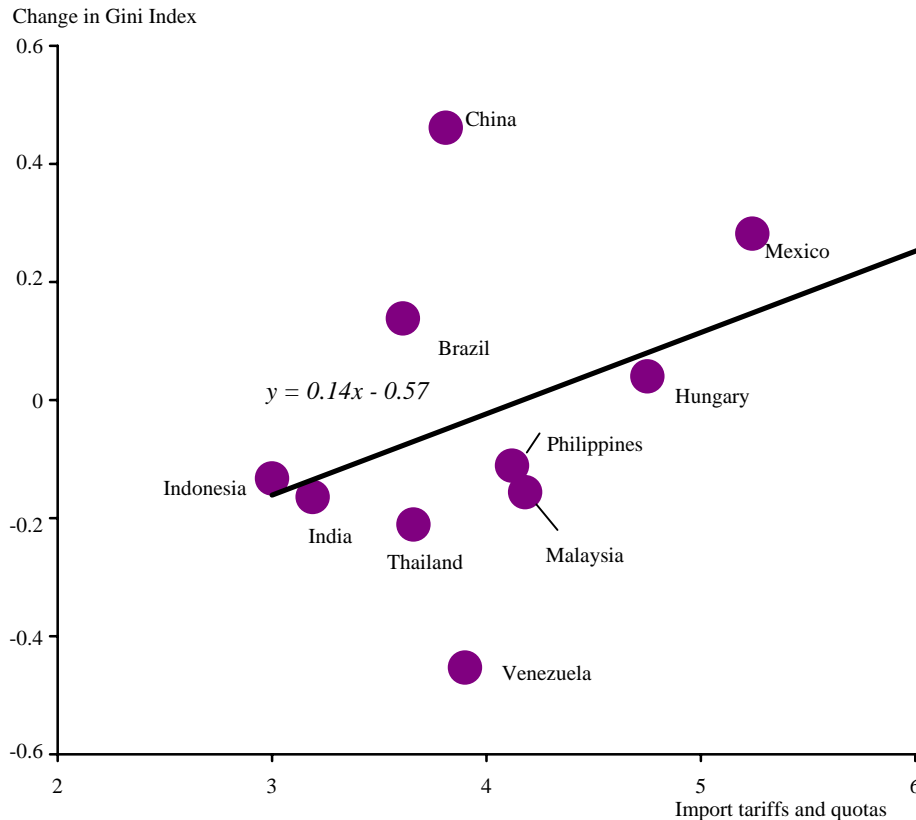
The degree of income inequality differed widely within the sample, ranging from a Gini index of about 25 in Hungary and the Czech Republic to slightly below 60 in Brazil and Chile.²⁴ But overall growth trends are unrelated to these differences [Nunnenkamp (2002), Figure 17]. The frontrunner in terms of catching up, Korea, had a substantially less uneven income distribution than the follower Chile. Korea and Pakistan were worlds apart in terms of per-capita income growth, but very close in terms of income distribution. A similar diversity prevails when openness to imports is plotted against income inequality [Nunnenkamp (2002, Figure 18)]. Chile, the most open sample economy according to survey results of the World Economic Forum (1999), is characterised by a similarly uneven income distribution as Brazil, which is rated relatively closed. Korea and Malaysia differ only slightly in terms of openness, but significantly in terms of income inequality.

It is obviously more appropriate to correlate the trade and growth variables with the *change* in income distribution than with the level of the Gini index in a specific year. This meets with serious data constraints, however. The (annualised) change in the Gini index could be calculated for just 11 of our 18 sample countries, based on data for varying time spans given in Dollar and Kraay (2001). The income distribution became more even in seven countries (including Pakistan) according to this source, whereas the Gini index increased in Hungary, Brazil, Mexico and, most steeply, in China.

Figure 8 reveals that it was mainly in Mexico (and less so in Hungary) where openness to imports was associated with increasing income inequality. The case of Mexico tends to support the argument of the World Bank (2002: 5), according to which rising income inequality observed for Latin American globalisers is “due to prior extreme inequalities in educational attainment”.²⁵ China and Venezuela, which were close neighbours in the rating of openness to imports, represented the extremes with respect to changes in the Gini index.

²⁴A Gini index of zero represents perfect equality, while an index of 100 implies perfect inequality.

²⁵Note also that Mexico scored very badly within a sample of emerging markets with regard to the quality of public schools as well as math and science education [Nunnenkamp (2001b)].



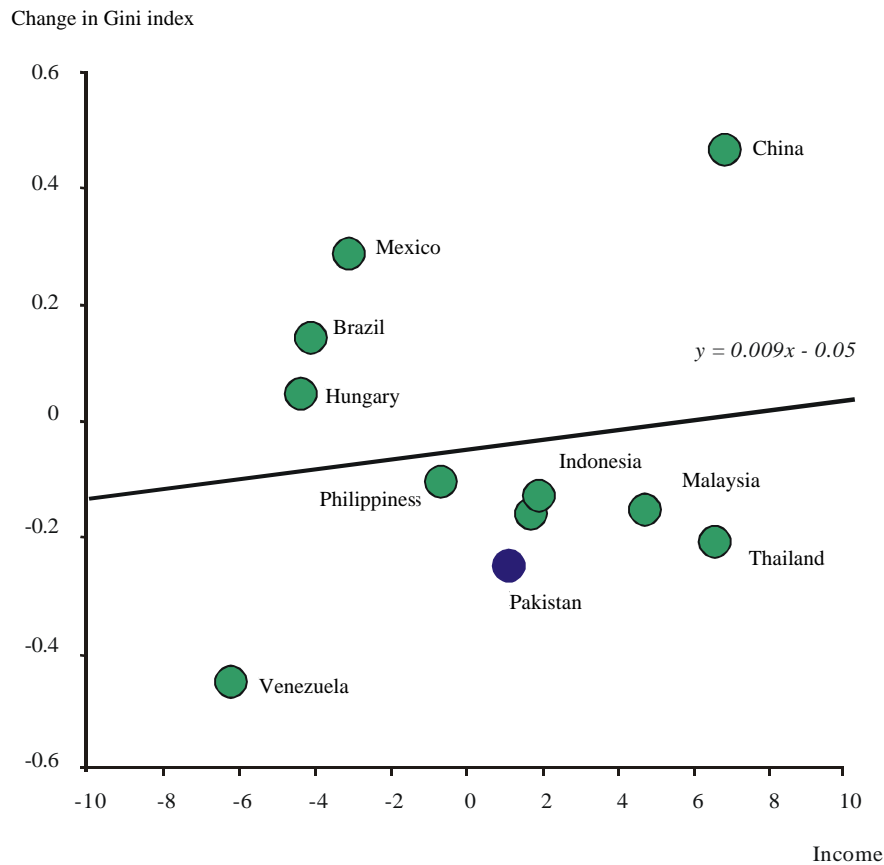
Source: Dollar and Kraay (2001); World Economic Forum (1999).

^aAnnualised for varying periods of observation, as reported in Dollar and Kraay (2001: Table 4); available from this source only for 11 countries of the sample considered here.

^bImport tariffs and quotas; score ranging from 1 (= highest import barriers) to 7 (= lowest import barriers); not available for Pakistan.

Fig. 8. Change in Income Inequality^a and Openness to Trade.^b

In Figure 9, China stands out as the only country in which economic catching up to the United States was associated with a widening income inequality within the economy. Even the case of China offers at best weak support to the claim of globalisation critics. The World Bank (2002: 5) considers the rise in Chinese inequality to be “far less problematic”, compared to cases such as Mexico. This is because the rise started from a fairly low level of the Gini index (32 in 1980). In the late 1990s, income inequality in China (Gini index: 40.3 in 1998) was still slightly below the sample average. The World Bank (2002: 5 f.) further notes: “If this increase in inequality in China has been the price of growth, it has paid off in terms of a massive reduction in poverty.”



Source: World Bank (a); Dollar and Kraay (2001).

^aAnnualised for varying periods of observation, as reported in Dollar and Kraay (2001: Table 4); available from this source only for 11 countries of the sample considered here.

^bChange in per-capita income (PPP), relative to the United States, in 1985–2000 (percentage points).

Fig. 9. Change in Income Inequality^a and Per Capita Income Growth.^b

Apart from the interpretation of the Chinese experience, all other episodes of catching up in Figure 9 went along with reduced income inequality. At the same time, all other countries with increased income inequality failed to catch up economically. Hence, the experience of the emerging economies considered here does not support the view that growth-promoting policies typically result in rising income inequality within countries. This is not to say that participating successfully in globalisation provides a panacea for overcoming deep-rooted problems of income inequality.

VI. SUMMARY AND CONCLUSIONS

Empirical evidence does not support the claim of globalisation critics that world-market integration, driven by foreign trade and investment, benefits only the rich and is bound to widen income disparities. Developing and newly industrialising economies can participate successfully in globalisation and narrow the income gap to industrial countries, even though many have failed to do so. The growth performance across developing countries is highly diverse, with failures in catching up being concentrated in small economies, notably in Africa. Hence, the balance of catching up versus falling back shifts to the former, once the number of people living in successful globalisers among Third World economies is taken into account.

Within countries, “globalisation generally reduces poverty because more integrated economies tend to grow faster and this growth is usually widely diffused” [World Bank (2002: 1)]. Furthermore, world-market integration and overall income growth have not, typically, led to greater income inequality within countries.

The vastly different experience of developing countries with globalisation during the last two decades has important policy implications. In contrast to widespread concerns, national policy-makers are not rendered powerless by globalisation. Economic adjustment and restructuring represents the – frequently neglected – link between the globalising environment and the growth performance of particular countries. National policy-makers may promote adjustment and restructuring by removing bottlenecks to factor accumulation, related to both physical and human capital, and by opening up their economies to foreign trade and FDI.

The task of creating a favourable investment climate has various dimensions. As the World Bank (2002: 19) notes, “a sound investment climate is not one full of tax breaks and subsidies for firms”. Rather, the challenge is to create an environment of good economic governance (including control of corruption, contract enforcement and protection of property rights), to meet the demand of firms for business-related services (e.g. transport, communication), and to provide for better education and training of the labour force.

More and better education is particularly important for poor segments of the population. It is for two reasons that education of the poor should figure high on the agenda of national policy-makers. First, it helps economy-wide catching up to more advanced countries. Second, broader access to education helps prevent rising income inequality within developing countries when they open up towards the world economy.

REFERENCES

- Bannister, Geoffrey J., and Kamau Thugge (2001) International Trade and Poverty Alleviation. International Monetary Fund, Washington, D. C. (IMF Working Paper WP/01/54.)

- Barro, Robert J. (1991). Economic Growth in a Cross Section of Countries. *The Quarterly Journal of Economics* 106:2, 407–443.
- Collins, Paul (1998). Regional Trading Blocks and Foreign Direct Investment Flows and Stocks. In John H. Dunning (ed.) *Globalisation, Trade and Foreign Direct Investment*. Amsterdam. 28–48.
- Corden, W. Max (1988) Debt Relief and Adjustment Incentives: A Theoretical Exploration. International Monetary Fund. Washington, D.C. (IMF Working Papers WP/88/36.)
- Dollar, David, and Aart Kraay (2000) Growth Is Good for the Poor. World Bank, Washington, D.C. <http://www.worldbank.org/research>
- Dollar, David, and Aart Kraay (2001) Trade, Growth, and Poverty. World Bank, Washington, D.C. <http://www.worldbank.org/research>
- Gundlach, Erich, and Peter Nunnenkamp (1997) Labour Markets in the Global Economy: How to Prevent Rising Wage Gaps and Unemployment. Institute for World Economics, Kiel. (Kiel Discussion Papers 305.)
- Mankiw, N. Gregory, David Romer, and David N. Weil (1992) A Contribution to the Empirics of Economic Growth. *The Quarterly Journal of Economics* 107:2, 407–437.
- Moser, Gary, and Toshihiro Ichida (2001) Economic Growth and Poverty Reduction in Sub-Saharan Africa. International Monetary Fund. Washington, D.C. (IMF Working Paper WP/01/112.)
- Nunnenkamp, Peter (1998) Lateinamerika nach der “verlorenen Dekade”: Eine Zwischenbilanz der Reformen. Institute for World Economics, Kiel. (Kiel Discussion Papers 324.)
- Nunnenkamp, Peter (1998a) Wirtschaftliche Aufholprozesse und “Globalisierungskrisen” in Entwicklungsländern. Implikationen für die nationale Wirtschaftspolitik und den globalen Ordnungsrahmen. Institute for World Economics, Kiel. (Kiel Discussion Papers 328.)
- Nunnenkamp, Peter (2001) Foreign Direct Investment in Developing Countries. What Policymakers Should Not Do and What Economists Don’t Know. Institute for World Economics, Kiel. (Kiel Discussion Papers 380.)
- Nunnenkamp, Peter (2001a) The Advantages of Emerging Markets in a Global World: How Mexico Compares with Major Competitors. Institute for World Economics, Kiel. (Mimeographed.)
- Nunnenkamp, Peter (2002) Why Economic Growth Trends Differ So Much across Developing Countries. The Globalisation Debate and Its Relevance to Pakistan. Institute for World Economics, Kiel. (Kiel Working Papers 1091.)
- OECD (2001). *International Trade by Commodities Statistics*. Paris.
- Sachs, Jeffrey D., and Harry P. Huizinga (1987). US Commercial Banks and the Developing-Country Debt Crisis. *Brookings Papers on Economic Activity* 2, 555–601.

- Sachs, Jeffrey D., and Andrew M. Warner (1995) *Economic Convergence and Economic Policies*. National Bureau of Economic Research, Cambridge, Mass. (NBER Working Paper 5039.)
- UNCTAD (1995) *Recent Developments in International Investment and Transnational Corporations. Trends in Foreign Direct Investment*. United Nations, Geneva. TD/B/ITNC/2.
- UNCTAD (2000) *World Investment Report 2000*. New York: United Nations.
- UNCTAD (2001) *World Investment Report 2001*. New York: United Nations.
- World Bank (a) *World Development Indicators, DC-ROM*. Washington, D.C.
- World Bank (1986) *World Development Report 1986*. Oxford.
- World Bank (2000) *Global Development Finance. Analysis and Summary Tables*. Washington, D.C.
- World Bank (2001) *World Development Report 2002*. Oxford.
- World Bank (2002) *Globalisation, Growth, and Poverty: Building an Inclusive World Economy*. Washington, D.C.: World Bank and Oxford University Press.
<http://www.worldbank.org/research>
- World Economic Forum (1999) *The Global Competitiveness Report 1999*. Geneva.
- World Economic Forum (2000) *The Global Competitiveness Report 2000*. New York and Oxford.

Comments

1.

This is a very interesting paper. It is quite suited for the Iqbal Memorial Lecture. After all, the spirit of Iqbal is truly to develop the economy of this country that he had conceived of. My own image of our National Poet is that of a modern learned Muslim comfortable with globalisation. You only have to read his book *The Reconstruction of Religious Thought in Islam* to discover his vision of a modern Muslim nation that would adopt globalisation and modernity as a path to progress.

This paper gives answers to the question: Is globalisation an economic steroid or a poisoned chalice? The empirical evidence about some developing economies that are actively participating in globalisation is presented, showing that openness to trade and investment accelerates growth. It has enabled these countries to gradually converge on the rich countries. Also these converging economies have not had a deterioration in income inequality. Openness clearly has been a force for convergence and poverty reduction. Globalisation for this group of countries has been an economic steroid.

As a globaliser, I welcome any addition to our knowledge that confirms the goodness of international integration. In this context, I welcome the conclusions of the paper and congratulate the author on confirming Allama Iqbal's beliefs as well.

Despite the demonstrated benefits of an open strategy, anti-globalisation sentiments have been on the rise. Violent protests at the IFI meetings clearly demonstrate how emotional the globalisation issue has become. This question, therefore, has received a lot of attention from scholars to sort out pertinent issues from non-issues. This paper is an addition to the long list of studies on the topic. There are a number of popular bestsellers on the topic as well. The debate has moved well beyond the point that this paper takes us to. The abundant literature documents the persisting global disparities and the lack of convergence in large parts of the developing world population (whole countries or regions within countries) to the OECD living standards. Globalisation has been a poisoned chalice to most countries.

To my mind, the author would have served us well if he had simply summarised the current debate on globalisation beyond the self-serving literature put forward by the IFIs. Such a summary would have also allowed his hypothesis of *globalisation fostering convergence* to offer a better set-up. The paper, in my view, appears to exist in a kind of vacuum. It misses out on the many theoretical and

empirical developments since Barro and Sala-I-Martin's famous book on globalisation.

I shall try to briefly outline factors explaining why a large part of the world is not like the countries that have caught up with the rich countries. I shall group my comments under six main headings: methodology, convergence and geography, convergence and institutional and policy differences, fickle capital flows and national policy, the impact of openness within a micro-economic perspective of firms and households and spillovers.

- (1) **Methodology.** Growth econometrics is now well developed. Barro's lectures on economic growth provide an excellent survey and present more interesting graphics than the paper before us. Sala-I-Martin, in the 1998 AEA meetings, used an eclectic approach in a paper titled "I Ran Four Million Regressions" to attempt to summarise what we know about growth. There is a lot to learn from this literature as to how best to summarise the evidence on growth dynamics. What surprises me is that despite the existence of this rich tradition of growth econometrics, the author retains a very simply graphical presentation relying largely on charts already published by the World Bank and the OECD. Indeed these charts are pretty easy to comprehend but only serve to set up the early hypotheses in the growth literature. It is O.K. to start with correlations. One needs to carefully sort out the causal connections between variables.
- (2) **Convergence, natural geography and ecology.** A large and rich literature explains the lack of income convergence in the perspective of the role of natural geography and ecology. The geography matters because it defines your natural resources base as well as your potential for integration with the global economy. It is interesting to note that the vast majority of world output is produced within 100 kilometers of the sea or a major river. Natural openness leads to wealth. Isolated inland regions face major transportation challenges. In addition, tropical areas face challenges of disease and agricultural sustainability. This literature powerfully argues against absolute convergence—a conclusion that is opposite to the one reached in this paper. It also explains better as to why global inequality has persisted for so long. Once again the literature has moved beyond where this paper wishes to take us. The impression that absolute convergence is possible is more a statement of faith than a scientific statement since it states the belief that something that has not happened for good reasons can nevertheless happen in the future.

- (3) **Convergence, economies of scale, and institutional and policy differences.** The implicit model behind the paper assumes that all countries have similar institutional framework when in fact institutional and policy differences between countries are large. In view of the existence of increasing returns to some important activities, public investment can have important and permanent effects on the location of production. In other words, man-made geography also matters. In this context, one can argue that the Maldives, which has access to the sea but suffers from insufficient scale of agglomeration, shall never catch up with the USA. Once again, the literature has moved way beyond where this paper wishes to take us. Openness without institutional improvements confers little benefits from globalisation.
- (4) **Fickle capital flows and national policy.** Debate on globalisation has progressed way beyond this paper's analysis. Populists like Tom Friedman have extolled the virtues of globalisation in a bestseller *The Lexus and the Olive Tree*. In this view, like Santa Clause, Globalisation brings costless presents and rewards good behaviour. But what room globalisation has for national policy? Friedman argues that the "electronic herd"—the mass of lenders and speculators—who can move billion of dollars around the globe in an instant reduces domestic policy choices to those between Pepsi and Coke with all other flavours banished? Many countries were persuaded by this dictum and began to bind themselves to the international economy in the hope of obtaining the large inflows that Mr Nunnenkamp also talks about. None more faithfully than Argentina. Even before the collapse of Argentina, scholars like Dani Rodrik, a Turkish professor at Harvard, had already begun to argue that fickleness of the "electronic herd" can also easily lead to an *Argentina* or provide the capital for the development of Korea. Therein lies the dilemma of globalisation. And that is the debate. This paper appears to predate that debate. It simply ignores the onset of the Asian Crisis and the factors responsible for this major catastrophe. I would argue that the Rodrik critique of globalisation has to be confronted by any serious academic study. It cannot just be wished away or ignored. Without a solid domestic financial system, short-term flows can be highly disruptive. Policy towards capital inflows is a key component of domestic financial regulations. Avoidance of crisis also helps in avoiding adverse consequences on poverty and social indicators as had happened in East and south Asia in their recent episode.

- (5) **Openness and micro-economic foundations** of a society are crucial in analysing the impact of globalisation on firms, industries, households, and workers. To what extent does the competition with transnational companies stimulate or hinder the development of indigenous firms and local capacity to learn? Openness may generate more employment and wage growth. It may also lead to higher wages dispersion—that is, a higher skill premium for the skilled workers. One needs to reconcile this with the lack of a relationship between openness and household income inequality at the macro level—a relationship that the author had relied on to trace the impact of openness on poverty situation. There is also a lot of concern about globalisation and its impact on the environment and the quality of life issues—freedom, culture, AIDS, crime, and terrorism. There may be no simple link between openness and these issues. The key issue here is again the presence or absence of institutions and policies to complement openness. These issues are left un-addressed by the author.
- (6) **The topic of spillovers is another missing area in the paper.** This is perhaps the most powerful argument in favour of globalisation that should receive a lot more attention that it has. Helpman and others have shown that there are very large learning spillovers from global integration. The importance of the technical change in the developed countries is a powerful source of growth for the developing world. The treatment of globalisation in terms of trade and capital flows alone misses out on the positive externalities from the knowledge revolution. In our daily lives we have also noticed the impact of spillovers when we use computers and internet in the middle of nowhere. Education is an important area where such spillovers impact on a society like Pakistan. Most of the people in this room have had an education spillover from some foreign university and all of what I have used here is from the “global knowledge tray”.

The speaker here is from Germany to exchange ideas with us and to create a globalisation spillover. I thank him for that and urge him to keep us current with knowledge in the West. The purpose of speakers like him at such forums is to keep us current and globalised. That certainly means participating in today’s debate and not yesterday’s debate. To summarise, the possibility of absolute convergence of income levels between the poor and rich countries is remote in view of the importance of constraints emerging from natural geography, ecology, and endogenous technical change occurring mainly in the developed countries. Some form of conditional convergence as alluded to by the author in the form of rapid and effective economic restructuring, including technical adaptation, is a more feasible policy goal for developing countries in their development race. For this to happen

quickly requires skills in grappling with a correct policy and institutional mix—a commodity in short supply in the countries aspiring to catch up with the rich countries.

In closing, I must thank Peter Nunnenkamp for bringing globalisation and growth issues on our research and policy agenda. The unfriendly tone is meant to stimulate discussion on the missing areas.

Sarfraz Khan Qureshi

Mahbab ul Haq Human Development Centre,
Islamabad.

2.

Let me congratulate Dr Peter Nunnenkamp for writing such a comprehensive paper on a very important topic. In his paper he has covered three broad areas: he has responded to the critiques of globalisation with the help of a variety of empirical evidence; he has also identified factors that have impeded growth performance in Pakistan; and he has dealt with some unjustified concerns quite often expressed in the critiques on globalisation. I shall comment on the these three broad areas.

(i) Response to the Critiques

Let me state at the very outset that the process of globalisation is a reality; it is here to stay! It brings opportunities but, at the same time, poses serious challenges to the nations. It permits a greater international division of labour and a more efficient allocation of resources. Countries gain access to larger markets, more sophisticated technology and a wider variety of goods and services at lower cost. But globalisation also entails risks. While globalisation enhances rewards of good policies, it also accentuates the cost of policy slippages. Any policy slippage can lead to large and destabilising capital flows, heightened exchange rate volatility and pressures on the banking system. Globalisation can bring major benefits to countries that can participate effectively in the process. Countries that fail to participate effectively in the process run the risk of being marginalised and left behind. We cannot turn back globalisation. The challenge is to make globalisation an instrument of opportunity and inclusion—not of fear and insecurity.

Peter Nunnenkamp has very strongly defended the process of globalisation by providing a variety of empirical evidence. While I am sympathetic to his whole hearted defense, yet I believe, all is not well for the developing countries in the process of globalisation. While globalisation has increased high level of interdependence, the world is polarised into developed and developing groups with vast economic differences. People in the developed countries enjoy higher per capita income and standard of living while developing countries are struggling hard to provide minimum basic needs to their population and constantly blaming the unjust economic order for their underdevelopment. They also face numerous problems with respect to the access to market, capital flows, overseas employment migration of labour, mounting external debt burden, transfer of technology, economic disparity and poverty.

Something *is* wrong when the richest 20 percent of the global population receives more than 80 percent of the global income. Something is wrong when the average income for the richest 20 countries is 37 times the average for the poorest

20. Something is wrong when 1.2 billion or 1/5th of the humanity still live on less than a dollar a day and 2.8 billion or almost half of the humanity still live on less than two dollar a day.

No one can deny the general benefits of the globalisation, but globalisation with a human face does require concerted efforts at both the national and international levels. Globalisation must work for all by following the basic principles of equity, solidarity, responsibility, participation, and ownership. We need to share the common concerns of the developing countries and make them believe that globalisation process is in no way intended to harm them. There is a growing concern in developing countries that the fruits of globalisation are not shared fairly and equitably. These feelings have given birth to many a Seattle. The concerns of the developing countries are, to a larger extent, genuine. Developing countries need better treatment. Growth and prosperity in developing countries are in the larger interest of the developed world itself. Developing countries would like to see the global trading regime to be fairer and equitable. Market access be provided to the products of developing countries, particularly for agricultural products, textile, and clothing; use of antidumping and countervailing duties be minimised. Developed countries must consider reducing debt burden of developing countries through various initiatives. The debt relief must go beyond HIPC initiatives. It is absolutely clear that debt relief without increased market access would be meaningless.

But at the same time, the developing countries must bring their act together. They must put in place a set of complementary policies that are essential for making globalisation work in the people's favour. In particular, the developing countries must pursue sound, coherent, and consistent macroeconomic policies. These should be transparent, stable, and predictable. They must continue to reform their economies to remove structural impediments to their growth and prosperity; improve their governance; invest in economic and social infrastructure; strengthen their financial sector; continue to pursue trade liberalisation; and participate in internationally accepted standards and codes of best practice covering macroeconomic policy and data transparency.

(ii) Why Pakistan Lagged Behind?

Dr Nunnenkamp has identified three factors that are responsible for impeding growth performance in Pakistan when compared with other Asian countries. These factors are: low investment ratio, poor social indicators, and lack of openness to trade. I believe that these are not the factors but the outcomes of the macroeconomic policies we pursued for many years. We sustained a budget deficit which was twice as high as the average of Asian developing countries for a long period of time. We also sustained large current account deficit, again for a long time. The natural outcome of such policies is the higher and faster accumulation of public debt. As such, investment is bound to be lower, growth would be lower as well, poverty

would rise, and social indicators would be poor. As far as openness is concerned, along with Pakistan, the international environment is also responsible for the lack of openness.

(iii) Some Unjustified Comments

There is a general perception that excessive foreign debt may hinder economic growth by providing a disincentive to investment. The empirical evidence provided by Peter Nunnenkamp does not support the general perception. While he finds negative correlation between external debt and investment, he finds no evidence of negative correlation between debt and per capita income growth. In the case of the former, he correlates Debt/GNP ratio with Investment/GNP ratio, but in the case of latter, he correlates Debt/GNP with growth of per capita income, but no significant relation between the two variables was found. I think he might get conclusive evidence if he correlated debt/GNP ratio with per capita income and *not* its growth. He may get a negative and significant correlation.

Lastly, Peter Nunnenkamp has found no convincing evidence justifying the concern that world market integration would increase income inequality within emerging economies. I believe that world market integration *will* increase income equality within emerging economies because overall income gains will depend on how effectively each economy is participating in the process of globalisation. To the extent that their level of preparedness and level of effective participation differ, the income gains would differ as well, and income inequality would be higher.

I have taken enough time to respond to a very comprehensive paper. I have enjoyed reading the paper, and we should all be grateful to the author for presenting and excellent paper on a very important topic.

Ashfaq H. Khan

Ministry of Finance,
Islamabad.